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RUCPDOG/DEPT OF COMMERCE WASHDC PRIORITY
RUEATRS/DEPT OF TREASURY WASHDC PRIORITY
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C O N F I D E N T I A L SECTION 01 OF 02 MOSCOW 003650

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E.O. 12958: DECL: 07/25/2017

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SUBJECT: RUSSIA: STRATEGIC SECTOR LAW MOVES TO DUMA

REF: MOSCOW 517

Classified By: ACTING ECON M/C KATHLEEN DOHERTY

11. (SBU) SUMMARY. On July 17, PM Fradkov sent the draft Law on Foreign Investment in the Strategic Sectors (SSL) to the State Duma, currently on summer recess and reconvening September 3. The Ministry of Industry and Energy's (MIE) revised version streamlines the review process, broadens the definition of foreign investor to include other forms of foreign control, and includes a paragraph in Article 7 giving the federal security services investigative authority to determine the extent of foreign control. The GOR appears to have put off the decision about the draft amendments to the sub-soil legislation, which would spell out which "strategic" deposits are off limits to foreign control, until after the March presidential elections. END SUMMARY.

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NEW AND IMPROVED DRAFT

12. (SBU) Despite Fradkov's televised criticism of the draft SSL law during the government meeting in January (reftel), the version he sent to the Duma on Tuesday looks much like the law he had earlier sent back to the MIE for rewriting. The draft law still lists the same 39 economic activities considered "strategic" and maintains the same 50 percent ownership/control thresholds that trigger a review. The activities listed in the draft law concern roughly six sectors; nuclear, defense, aviation, space, encryption, and natural monopolies. Within these sectors, a review is not necessary if the foreign investor seeks to acquire a minority or a non-controlling stake in the enterprise. Restrictions to foreign investment in strategic sub-soil deposits were taken out of the SSL in January and are treated separately in amendments to the Sub-Soil legislation, which are still bogged down in government review (reftel). In all other sectors not on the list, the law does not apply. If the foreign company is either owned or controlled by a foreign government, the law limits the permissible stake in these enterprises to 25 percent. Along with the SSL, a series of amendments to existing laws have been submitted to reconcile those laws with the SSL.

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13. (C) The review process has been streamlined in the current version of the draft law. The previous version required three layers of decisions with some cases requiring

presidential approval. The process now begins with the interested foreign investor informing the authorized government body, not specified in the draft law, about the proposed transaction and submitting all required documentation to it. The authorized body then has one month to forward the application along with its proposal to an inter-ministerial commission chaired by the PM. According to a Presidential Administration (PA) expert on the SSL, Stanislav Voskresenskiy, although the commission's membership is to be determined later by the GOR, he expected it to include representatives from the economic and security ministries. The commission will have three months to decide on the application from the date of registration with the authorized body. In exceptional cases, the GOR can extend the deadline for another three months.

¶4. (SBU) Another change in the draft law is a more flexible definition of a foreign investor to take into account other corporate structures that might also constitute foreign control. For instance, control could be exercised by a group of foreign investors acting in concert or third party intermediaries or management acting on their behalf. Control is no longer strictly equated with ownership of 50 percent plus one share of the target enterprise's equity.

¶5. (SBU) Unlike the previous version, the revised draft law includes an explicit role for the GOR's security services. Article 7 now includes a paragraph giving security agencies investigative authority to determine the control, direct or indirect, that a foreign investor would exercise over the target enterprise as the result of the transaction under consideration. A July 23 Kommersant article mistakenly indicated that the draft law gives the FSB a conditional veto

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over proposed foreign acquisitions of these enterprises. (BEGIN COMMENT: While in practice, the FSB probably could derail a proposed foreign acquisition of a strategic enterprise through an "adverse finding", the draft only spells out their investigative authority. END COMMENT.)

COMMENT

¶6. (C) After two years of back and forth between the various ministries and agencies that have fought to shape this draft law, the SSL seems poised to becoming law. Our contacts in the PA and the MIE have told us that they expect the law to pass quickly through the Duma. In discussions with members of the business community who are not involved in the energy sector, the consensus seems to be that the SSL fills a legislative vacuum and passage would be a positive development. Even then, as the chairman of the Foreign Investment Advisory Council pointed out to us, the law would apply to only a tiny fraction of actual business deals that his members would be interested in. In the energy sector, oil companies do not appear overly concerned that amendments to the sub-soil legislation did not accompany the SSL to the Duma. In the words of one oil company analyst, the sub-soil amendments will appear once the Kremlin has a firm grip on all the strategic deposits.

¶7. (SBU) An unofficial translation of the SSL has been sent to the Russia desk at State. END COMMENT.
RUSSELL